SUPREME COURT, U. S.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

No. 71-421

TEXAS GULF SULPHUR CO., ET. AL.,
Petitioners,

—v.—

WALTER A. MITCHELL, ET. AL.,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

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BRIEF FOR RESPONDENTS IN OPPOSITION

Respondents Walter A. Mitchell and George Gordon Reynolds submit their brief in opposition to the Petition for a Writ of Certiorari.

OPINIONS BELOW

The opinion of the United States District Court for the District of Utah is reported at 309 F. Supp. 548 and set forth

at page 1a of the Appendix to the Petition. The opinion of the Court of Appeals is not yet reported but is reproduced at page 40a of the Appendix to the Petition.

JURISDICTION

The judgment of the Court of Appeals was entered on April 26, 1971. A timely petition for rehearing was denied on September 10, 1971. The Petition for Certiorari was filed on September 23, 1971. This Court's jurisdiction is invoked under 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

1. Whether, in a cause of action based upon the federal securities laws, the Courts may judically add elements to the cause of action other than those specified by Congress and the Securities and Exchange Commission.

2. Whether the release of a false statement in financial news services is a sufficient use of facilities of interstate commerce, for the purpose of jurisdiction.

3. Whether the federal district court may properly fashion a rule of damages suitable to fraud in connection with the sale of securities in a rising market.

STATUTE AND RULE INVOLVED

The pertinent provisions of the Securities Exchange Act of 1934 (Exchange Act), and Rule 10b-5 adopted thereunder (17 C.F.R. 240.10b-5) (Rule 10b-5) are as follows:

15 U.S.C. §78j:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of

interstate commerce or of the mails, or of any facility of any national securities exchange—

• • •

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. §78aa:

The district courts of the United States, the district court of the United States for the Disrict of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this title or rules and regulations thereunder, or to enjoin any violation of such title or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found . . . .

Rule 10b-5:

It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumsances under which they were made, not misleading or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

STATEMENT

On April 12, 1964 petitioners Texas Gulf Sulphur Company (TGS) and Charles F. Fogarty issued a statement to the news media discounting rumors concerning its mineral explorations near Timmins, Ontario, Canada which had reportedly leaked out because of large purchases of TGS stock by corporate insiders (deceptive release). Four days later, on April 16, 1964, TGS confirmed the discovery of a mine at Timmins which has since proven to be one of the most spectacular mining discoveries in history (corrective release). All of the essential information contained in the April 16 release was based upon exploration which had been completed prior to April 12, 1964, and a materially significant portion of which had been available to TGS since November of 1963.

Respondents were shareholders in TGS on April 12, 1964 who sold their stock on the morning of April 16, before the corrective release was communicated to them or was reasonably available to members of the investing public. They claimed that the April 12 release, in light of the disclosures contained in the corrective release, was materially false and misleading and that the deceptive release caused them to sell their stock.

The trial judge entered judgment for the plaintiffs and held that because of the peculiar facts of a fraudulently induced sale of stock in a rapidly rising market, damages should be

calculated according to the difference between the price at which the plaintiffs sold and the average market price of TGS shares during 20 trading days following the sale, reasoning that the impact of the disclosure of the corrective release was felt by the market during that period of time. The Court of Appeals affirmed, but modified the damage award by requiring that damages be calculated according to the market high during the 20 succeeding trading days rather than the average during those trading days. The Court of Appeals reasoned that calculating damages according to the market high was desirable in the interest of providing maximum deterrence to securities fraud.

Petitioners incorrectly state that Respondents "sales had taken place *after* dissemination of the second press release" (emphasis by Petitioners). The key word here is "dissemination," and on uncontroverted evidence both the trial judge and the Court of Appeals concluded that the second press release had not been "disseminated" in the sense that it was not reasonably available to Respondents or to members of the investing public. Indeed, as to the sale of Respondent Reynolds, he instructed his broker to sell prior to the time when the corrective release had even been delivered to the news media. Respondents seek to make capital of the time lag between when the sell order was delivered and when trades were technically negotiated on the stock exchange, located thousands of miles away, at a time subsequent to the precise moment when the corrective release went out on the Dow Jones wire service.

ARGUMENT

The decision of the Court of Appeals, other than with respect to the question of class action treatment,* is correct. No

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* Respondents intend to separately petition this Court for review of the Court of Appeals treatment of the class action, within the time per-

conflict is presented, and the decision presents no important questions which merit review by this Court.

A. Review by this Court of the question of the nature, scope and extent of liability under section 10(b) of the Exchange Act (15 U.S.C. §78j) and Rule 10b-5 would be superflous. These very questions are presented in *Manhattan Casualty Co. v. Bankers Life and Casualty Co.*, Docket No. 70-60 (October Term, 1971) and *Affiliated Ute Citizens v. United States*, Docket No. 70-78 (October Term, 1971), both of which are now submitted on the merits and awaiting decision. Any guidance to the lower federal courts which is considered either appropriate or necessary on the questions of the proper connection between an allegedly fraudulent act and a securities transaction, or the propriety of "privity, short statutes of limitation, *scienter*, causation and undertakings for costs" (Pet. 18) will undoubtedly be supplied in either or both of said matters presently awaiting decision. Furthermore, Petitioners unabashed proposal that this Court should import restrictive provisions of other securities laws into Rule 10b-5 (Pet. 18-20) would emasculate the intent of Congress, for these other securities laws contain substantially different terminology. Thus, section 17(a) of the Securities Act of 1933 (15 U.S.C. §77q (a)) requires that the wrongful practices be "in the offer or sale" of securities, while section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78j) employs the much looser linkage "in connection with the purchase or sale of any security." The requirement of "reliance" was written into section 11(a) of the Securities Act (15 U.S.C. §77k(a)), and section 18 of the Exchange Act (15 U.S.C. §78r) includes a requirement of *both* reliance and scienter. *Neither* requirement was incorp-

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mitted by law. The class action is thought to be a matter of national importance, in that the 1966 amendments to Rule 23 have never been construed by this Court and present important questions of judicial efficiency.

orated in section 10(b), and to say that either requirement should be added by judicial construction, in the face of Congress' calculated use of these terms in other contexts in the same legislation, would be improper.

B. The question of jurisdiction over Petitioner Fogarty under provisions of Section 27 of the Exchange Act (15 U.S.C. §78aa) was decided correctly, and in accord with a large body of precedent under the Exchange Act. See 3 Loss, SECURITIES REGULATION 1523 (2d Ed. 1961):

> ". . . the mailed matter need not even be addressed to a victim; the misstatements may be made orally and the mails used by the defendants merely in communicating among themselves. Similarly, it suffices if the mails (or, under the SEC provisions, interstate facilities) are used only in making or postponing an appointment with the victim, or making an offer, or acknowledging receipt of an order, or confirming a transaction, or having a broker sell the securities fraudulently obtained.
>
> "Moreover, the use of the mails by the particular defendant may be indirect. Since the mail fraud statute covers anybody who 'knowingly causes [any matter or thing] to be delivered by mail' and all the SEC fraud provisions contain the phrase 'directly or indirectly,' it suffices to show that the defendant caused another person to use the mails or might reasonably have foreseen that their use would occur." (citations omitted)

Accord, Ellis v. Carter, 291 F. 2d 270 (9th Cir. 1961); *Matheson v. Armbrust,* 284 F. 2d 670 (9th Cir. 1960) *cert. denied* 365 U.S. 870 (1961); *Hooper v. Mountain States Securities Corp.,* 282 F. 2d 195, 204-05 (5th Cir. 1960) *cert. denied* 365 U.S. 814 (1961); *Fratt v. Robinson,* 203 F. 2d 627 (9th Cir. 1953).

C. The measure of damages adopted by the Court of Appeals is a reasonable one, and presents no question of na-

tional importance which should be reviewed by this Court. The statement of Petitioners that Respondents, who purchased their stock many years before at prices substantially lower than prevailed in April, 1964, "did not lose money" (Pet. 26) simply ignores the obvious. Moreover, this question is also awaiting decision in *Affiliated Ute Citizens v. United States*, Docket No. 70-78 (October Term, 1971). We subscribe to the SEC's statement of the proper measure of damages at page 58 of its *amicus curiae* brief in the *Affiliated Utes* case:

> "The measure of damages should always be at least equal to the plaintiff's loss – that is, the difference between the price he received and the price he would have received had there been no fraudulent conduct (usually the fair market price). A measure of damages based upon the profits, if any, realized by the defendant is appropriate . . . if that amount is greater than the plaintiff's actual loss, the theory in such case being that the shares are held in constructive trust for the plaintiff and that the defendant should not be enriched by his wrongdoing. *Janigan v. Taylor*, 344 F. 2d 781 (C.A. 1), certiorari denied, 382 U.S. 879."

This Court has taught that "where legal rights have been invaded, and a federal statute provides for a general right to sue for such invasion, federal courts may use any available remedy to make good the wrong done." *J. I. Case Co. v. Borak*, 377 U.S. 426 (1964). Consistent with that admonition, the Court of Appeals fashioned a damage measure suitable to the peculiar problems of a fraudulently induced sale of stock in a rapidly rising market. No conflict with established damage law is presented. *Compare, Galigher v. Jones*, 129 U.S. 193, 201 (1889).

D. The Court of Appeal's application of the state statute of limitations governing fraud actions, rather than the shorter statute of limitations contained in the state blue sky law, is

consistent with the weight of authority. *E.g. Charney v. Thomas*, 372 F. 2d 97, 99-100 (6th Cir. 1967):

> "Because of the remedial nature of the Blue Sky Law, it should be taken to provide an added cause of action for the defrauded plaintiff, rather than the only one.
>
> • • •
>
> "While several courts have considered the question of a limitation period for federal securities fraud actions under section 10(b), none has applied the provisions of the local Blue Sky Law in this regard."

Vanderboom v. Sexton, 422 F. 2d 1233 (8th Cir.) *cert. denied* 400 U.S. 852 (1970) relied upon by Petitioners (Pet. 27) stands alone as an anomaly in the law. Against the weight of cases in accord with the Court of Appeals herein, it does not present a conflict meriting the attention of this Court.

CONCLUSION

For the foregoing reasons, the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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